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SUBJECT: Business Sees Nationalism as Bigger Risk than Elections

SENSITIVE BUT UNCLASSIFIED

¶1. (SBU) Summary. The head of Merrill Lynch's new Istanbul branch is not overly concerned about the short-term outlook for the Turkish economy or politics. He minimizes the double election year political risk, estimating a 95% chance that PM Erdogan will seek and get the presidency and a large probability that the AKP will retain a parliamentary majority, although a smaller one. He does not expect a strong immediate counter-reaction from the military or secular establishment, or least of all, from the business community. He sees the Turkish marketplace as brimming with opportunities, including for regional economic leadership. Such opportunities require strong political leadership to ride-out a nationalist trend that is fed by rapid political and economic change. Views like these are widespread in the big business community, whose main fear is not another AKP government but a return to the drift and stagnation of the 1980s and 1990s. End Summary.

¶2. (SBU) A secular Turk who was until recently a senior official in a leading Turkish bank, our contact concedes that the AKP has pursued business-friendly economic policies, but is worried that the fast pace of economic change has fed a resurgence of political nationalism to a perhaps unprecedented extent. He tells anecdotes of highly-educated, successful, "liberal" friends railing against Kurdish separatists and Greek Cypriots like they never had before. Such passions are fed, he believes, by the lack of progress on four key foreign issues: 1) PKK and northern Iraq, 2) Cyprus, 3) EU accession, and 4) relations with Armenia. Nationalists assert, rightly or wrongly, that Turkey has made "concessions" on each of these issues that have been rebuffed, leaving them feeling angry and betrayed by the national leadership as a whole (including the military). This is not a short-term, but a medium-term political risk that could come to a head in 2008 or 2009, absent progress on these four issues.

¶3. (SBU) As the economy changes, churning in the employment market, replacement of existing firms by new ones, and ongoing migration to the cities has created a sense of dislocation that encourages nationalist responses. No political party offers a compelling vision of hope in the future to guide people through turbulent times of change. The obvious candidate for such a national leadership role, he believes, is PM Erdogan. But for Erdogan to succeed in such a role, he would need to grow beyond his current religious/communitarian base and be accepted by a bigger cross-section of voters. Erdogan recognizes this, he thinks, and is looking for ways to broaden his support. This in turn has led to the high decibel politics of the opposition, which also recognizes his potential. A broader base would also help the AKP govern in a smarter, more strategic way, since new supporters would add to the party's intellectual and experiential pool.

¶4. (SBU) Nonetheless, Merrill Lynch is bullish on Turkey. Nationalist challenges are bumps on the road to modernity, and there is a vast untapped growth potential that could be realized with continued political stability and economic reform. Merrill Lynch is focusing on the real estate sector, which is a main employment

generator. Istanbul will be rebuilt from the ground up in ten years, given the huge amounts of money going into property and construction. Merrill Lynch's greater vision of its role is as an investment bank for an emerging class of regional business powerhouses. The branch chief cites the strong interest in his bank's recent eurobond issuance for Calik Energy as one example of a company growing beyond its local roots with foreign financing. Airport builder-operator TAV, which was recently taken public by Goldman Sachs, is another example, as are companies like Sisecam, Enka and Efes that are active in Turkey, Russia, and the Balkans and are expanding in the Middle East and Caucasus.

15. (SBU) Comment: Even if our contact goes too far downplaying election year risks, we report his views as an example of the outlook of Istanbul's secular, western-oriented big business community, which has traditionally played a decisive political role. The discounting of major election risk is also reflected in most market analyses, as is the growing concern -- what our contact called "the nightmare scenario" -- about nationalism over the longer term. It is also representative of the business perception of large opportunities in the Turkish marketplace that are balanced by large risks. Summed up, that risk is of a Turkey that is inward looking, rudderless and adrift, as it was for much of the 1980s and 1990s. Turkey's business community is decades ahead of its neighbors in places like Iraq, Syria, the Caucasus and Iran and has the potential to help those countries develop functioning market economies if politics allow. These views are thus a reminder of what is at stake in this election year and of the contribution economic engagement can make to Turkey's stability.

WILSON